No. 7128.

In the

United States Circuit Court of Appeals,

FOR THE NINTH CIRCUIT.

Erle P. Halliburton,
Petitioner,
vs.
Commissioner of Internal Revenue,
Respondent.
and
Vida C. Halliburton,
Petitioner,
vs.
Commissioner of Internal Revenue,
Respondent.

BRIEF OF PETITIONERS.

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BRIEF OF PETITIONERS.

HISTORY AND PREVIOUS OPINION.

The Commissioner of Internal Revenue, Respondent herein, on the 25th day of January, 1928, mailed to Erle P. Halliburton what is termed a deficiency letter wherein the Respondent proposed additional taxes for the year 1924 in the sum of $23,946.10. The Respondent, on

January 25, 1928, also sent a deficiency letter to Vida C. Halliburton wherein he proposed additional taxes against her for the year 1924 in the sum of $21,649.89. Appeals to the United States Board of Tax Appeals were taken by each of the Petitioners within the time required by law. Both appeals involved the same issues and were consolidated for hearing and decision before the United States Board of Tax Appeals.

Petitioners, from 1921 until July 1, 1924, carried on an oil well cementing business under the partnership firm name of E. P. Halliburton Oil Well Cementing Company. On July 1, 1924, pursuant to a written contract dated June 19, 1924, all of the assets of the partnership were transferred to a newly organized corporation known as the Halliburton Oil Well Cementing Company solely in exchange for stock. On July 23, 1924, also pursuant to said contract, the corporation acquired the sum of $130,000.00 in exchange for a portion of its stock.

The questions presented before this Honorable Court are:

1. Whether Petitioners realized taxable gain on the exchange by them of partnership assets for stock of Halliburton Oil Well Cementing Company; and

2. Whether the gain, if any, realized by Petitioners is taxable at the capital gain rates or the ordinary rates provided in the Revenue Act of 1924.

The Board of Tax Appeals held that the Petitioners sustained a taxable gain when they transferred their partnership assets for stock of the new corporation.

Petitioners contended that the transfer of the partnership assets solely for stock of the corporation constituted a tax-free exchange within the meaning of the provisions of Section 203 (b) (4) of the Revenue Act of 1924. They also contended that if any taxable gain resulted it was taxable only at the rate of 12½%. The Board of Tax Appeals held that the exchange resulted in taxable gain to Petitioners and that such gain should be taxed at the normal and surtax rates.

Jurisdiction.

Erle P. Halliburton and Vida C. Halliburton are residents of the City of Los Angeles, County of Los Angeles, State of California. The decision of the United States Board of Tax Appeals was promulgated on March 30, 1932, and the final orders of redetermination were entered on March 31, 1932. [R. pp. 58, 59.]

Petitioners filed their petitions for review by this Honorable Court with the Clerk of the United States Board of Tax Appeals on September 23, 1932. [R. pp. 83, 96.] These appeals were taken pursuant to the provisions of Sections 1001, 1002 and 1003 of the Act of Congress approved February 26, 1926, entitled the "Revenue Act of 1926" (44 Stat. 1, 109, 110; U. S. C. A., Sections 1224, 1225, 1226), as amended by Section 603 of the Act of Congress approved May 29, 1928, entitled "The Revenue Act of 1928" (45 Stat. 873).

Questions Involved.

I.

Did petitioners realize a taxable gain on account of the exchange by them of the assets of the partnership solely for stock in the Halliburton Oil Well Cementing Company?

II.

If any gain was realized on account of the transfer by petitioners of their interest in the partnership assets solely for stock of the Halliburton Oil Well Cementing Company, was such gain taxable at the rate of 12½%?

Statutes Involved.

See Appendix pages 55-57.

STATEMENT OF FACTS.

Petitioners were equal owners of the partnership known as E. P. Halliburton Oil Well Cementing Company, hereinafter referred to as the partnership. [R. p. 47.] The partnership was established about March, 1921 [R. p. 98] (the Board found it was established in 1920), and until July 1, 1924, profitably operated the business of cementing oil wells. [R. p. 47.] The oil wells were cemented by a method described and claimed in United States Letters Patent No. 1,369,891, which was owned by the partnership [R. p. 98], it having been patented by Erle P. Halliburton on March 1, 1921. [R. p. 47.] The partnership also owned the equipment necessary to its business, certain real estate, supplies, and accounts receivable. [R. p. 47.]

On June 19, 1924, the Petitioners, as parties of the first part, entered into a written contract, hereinafter called the promoter's agreement, with seven certain oil companies as parties of the second part, which provided for the organization of a corporation under the laws of Delaware, to be known as the Halliburton Oil Well Cementing Company, hereinafter called the corporation, with authorized capital stock of the par value of $350,000.00 divided into shares of $100.00 each. Under the terms of the contract the parties of the first and second parts agreed to subscribe and pay for 1,780 and 1,300 shares of stock of the corporation, respectively. The remainder of the authorized shares was to remain in the treasury of the corporation for sale to the public. [R. p. 47.]

The agreement provided that the Board of Directors should be made up of seven persons, three to be selected by the stock held by parties of the first part, three by the stock held by parties of the second part and one to be chosen by Erle P. Halliburton and the second parties or by the president of a trustee which was to hold 480 shares out of the 1,780 shares of the corporation's stock. It also provided that Erle P. Halliburton should be president and general manager of the corporation at a salary of $15,000.00 per annum; that H. C. Gloeckler, a representative of the parties of the second part, should be vice-president on a salary of $4,200.00 per annum; and that a secretary-treasurer to be selected by the parties of the second part should receive a salary of $4,200.00 per annum. [R. pp. 47-48.]

The contract further provided that the 1,780 shares to be issued to Petitioners should be paid for by transferring to the corporation the following property and property rights [R. p. 119]:

(a) That certain license of rights to Erle P. Halliburton under that certain license agreement between Perkins Oil Well Cementing Company, as licensor, and Erle P. Halliburton, as licensee, of date December 20th, 1922, relating to the United States Letters Patent No. 1,011,484, granted December 12, 1911, for a Method of Cementing Oil Wells, etc.

(b) U. S. Letters Patent No. 1,369,891.

(c) The exclusive license for the use of U. S. Letters Patent No. 1,486,883.

(d) All other applications for patents now pending in the Patent Office and Letters Patent owned by Erle P. Halliburton or the partnership. [R. pp. 120-121.]

(e) All of the real estate owned by said partnership.

(f) All the personal property owned by said partnership. [R. p. 121.]

(g) The contract further provided that the transfer of the foregoing property should take effect as of date 12:01 A. M. July 1, 1924. [R. p. 122.]

On July 12, 1924, a meeting of the Board of Directors attended by six members thereof was held. At this meeting the certificate of incorporation and the by-laws adopted at the incorporators' meeting held at Wilmington, Delaware, on July 1, 1924, were duly ratified and adopted and the persons so designated in the promoter's agreement were elected to the respective offices of president, vice-president and secretary-treasurer at the salaries specified in such agreement.

Petitioners paid for their stock in the corporation in conformity with the terms of the agreement by delivering to it the good-will of the partnership, a license to use Patent No. 1,486,883 (the Board erroneously found as a fact that this patent was transferred to the corporation) [R. p. 48], also a license to use Patent No. 1,011,484 and a mixed body of partnership assets of character, cost and value as follows [R. pp. 48, 49, 130-133, 134-137]:

Profit and Loss on Sale of Assets and Miscellaneous Investments.

Description	Date Sold	Date of Purchase	Cost	Depreciation based on cost	Adjus. Cost	Sale Price	Profit or Loss
Autos	7-1-24	7-1-22-24	$12,660.88	$ 2,968.55	$ 9,692.33		
Trucks	"	1-1-22-24	32,435.20	13,438.17	18,997.03		
Pumps	"	"	17,894.16	7,723.05	10,171.11		
L. Stock	"	"	215.00	53.75	161.25		
Bldgs. (Field)	"	7-1-23-24	22,289.12	420.36	1,868.76		
Off. Bldg. Gar. & Shed	"	"	2,641.04	145.20	2,495.84		
Elevators	"	7-1-22-24	414.96	138.06	276.90	$178,000	$115,290.36
Shop Eq.	"	1-1-23-24	2,429.43	239.33	2,190.10		
F. & F.	"	1-1-22-24	1,894.45	230.79	1,663.66		
Wagons	"	7-1-22-24	612.00	431.33	180.67		
W. H. Supplies	"	1924	2,432.98		2,432.98		
R. E.	"	1922	362.50		362.50		
Patent	"	3-1-21	15,000.00	2,783.49	12,216.51		
Total			$91,281.72	$28,572.08	$62,709.64	$178,000	$115,290.36

The patent referred to in the above list of assets was Patent No. 1,369,891, having been granted on March 1, 1921. [R. pp. 139-142.] Included in the above list was property of the depreciated cost of $16,216.51 which had been owned by the partnership for more than two years. [R. p. 50.]

The corporation received all the property listed above on July 1, 1924 and from that date retained continuous possession thereof and operated the oil well cementing business theretofore carried on by the partnership. On and after such date all operating contracts were made in the name of the corporation which then opened a set of books that reflected its income and operations thereafter. At all times after July 12, 1924 representatives of the parties of the second part served on the Board of Directors and as officers of the corporation and participated in all its corporate acts and proceedings. [R. p. 50.]

The corporation from July 1, 1924 to July 22, 1924, inclusive, carried on the business of cementing oil and gas wells and caused accounting records of the said operations to be compiled and kept currently during that time, and the said corporation from July 1, 1924 to July 22, 1924, inclusive, cemented one hundred seventeen wells and made two sales of supplies to outside parties, the entire revenue from which was at all times claimed and kept, and was received by the said corporation. [R. pp. 111-112.]

During the same interval of time the said corporation dealt with outside parties in its own name in the purchase of necessary supplies, established a bank account in its own name, made a deposit therein and drew checks thereon in payment of current expenses and that during the same interval of time the said H. O. Gloeckler as Vice-President wrote to producers at various points in Texas and Oklahoma, advising them that the corporation was operating and had equipment available at various points in those states, with name of the superintendent or cementer in charge at each point, with the address and phone number where each superintendent or cementer could be reached, all in the name of the said corporation. [R. p. 112.]

For the period July 1, 1924 to July 22, 1924, inclusive, the corporation, in addition to its officers, employed clerical help, shop foremen, mechanics, warehouse men, cementers, and drivers and helpers in its own name, and that on or about July 15, 1924 payrolls showing said employees to have been in the service of the corporation for the period July 1, 1924 to July 15, 1924 were compiled and approved by H. C. Gloeckler, Vice-President, and H. T. Crain, as Secretary-Treasurer of the corporation, and the accounting voucher therefor was approved by H. C. Gloeckler as Vice-President and H. T. Crain as Secretary-Treasurer. [R. pp. 112-113.]

On July 17, 1924 the officers of the corporation had a policy of fire insurance written in the name of the said corporation on the buildings and equipment then in its possession and use, the major portion of which properties were those formerly owned by Erle P. Halliburton and Vida C. Halliburton. [R. p. 113.]

The real estate included in the list of partnership assets was transferred to the corporation by deed dated July 1, 1924, but the signatures of Erle P. Halliburton and Vida C. Halliburton affixed thereto were not attested until July 16 and July 23, respectively. The patent and patent rights included in the assets transferred were assigned to the corporation by instruments dated July 1, 1924, but the signatures thereto were not attested until July 23 of such year. [R. p. 50.] The foregoing instruments of title were, prior to July 23, 1924, turned over to the corporation.

On July 23, 1924, the parties of the second part paid in their subscription on the stock of the corporation in cash in the amount of $130,000.00. [R. p. 50.]

Immediately after the effective date of the organization of this corporation, Erle P. Halliburton and Vida C. Halliburton owned capital stock of the corporation represented by 1,780 shares of stock issued, or to be issued, for which they had paid in the assets of the partnership as above set out. The parties agree that the stock so acquired had a fair market value equal to the par value of $178,000.00 at date of its issue. [R. p. 51.]

Each of the petitioners herein made an income tax return for 1924. Neither included in such return any profit resulting from the transfer of the assets of the partnership to the corporation. Upon audit the Respondent determined that the effective date at which the corporation began business was July 23, 1924, and that profit was realized from the sale of the partnership assets to the corporation and asserted the deficiencies here in controversy. [R. p. 51.]

It is Petitioners' contention that the transfer by them of the partnership assets for stock in the corporation was a tax-free exchange and that if it was not a tax-free exchange the gain was subject to a tax of only 12½% inasmuch as the assets have been held for more than two years.

ASSIGNMENTS OF ERROR RELIED UPON.

Petitioners rely upon all the assignments of error which may be summarized as follows:

1. The Board of Tax Appeals erred in holding that Petitioners realized a taxable gain on account of the receipt by them of 1,780 shares of the capital stock of Halliburton Oil Well Cementing Company, a corporation, which were issued for all the assets owned by Petitioners in the partnership known as E. P. Halliburton Oil Well Cementing Company.

2. The Board of Tax Appeals erred in holding that Petitioners immediately after the receipt by the corporation of said partnership assets were not the owners of at least 80% of its issued and outstanding capital stock.

3. The Board of Tax Appeals erred in failing to hold that the transfer by Petitioners of their partnership assets to the Halliburton Oil Well Cementing Company, a corporation, solely in exchange for its stock was a tax-free exchange within the meaning of the provisions of Section 203 (b) (4) of the Revenue Act of 1924.

4. The Board of Tax Appeals erred in failing to hold that Petitioners were two of several persons who transferred properties to the corporation solely in exchange for its stock and immediately after the exchange such group of persons were in control of the corporation and the amount of stock received by each was substantially in proportion to his or her interest in the properties prior to the exchange, and in failing to hold that no gain or loss was recognized upon the transaction by reason of the provisions of Section 203 (b) (4) of the Revenue Act of 1924.

5. The Board of Tax Appeals erred in failing to find that the partnership known as E. P. Halliburton Oil Well Cementing Company was engaged in the oil well cementing business from about March, 1921 to July 1, 1924.

6. The Board of Tax Appeals erred in failing to find that all of the properties transferred to the corporation were properties the partnership acquired and used in its business.

7. The Board of Tax Appeals erred in failing to find that the Patent No. 1,369,891 transferred to the corporation and around which the partnership had been built had a value on July 1, 1924 of at least $100,000.00.

8. The Board of Tax Appeals erred in failing to find that all of the assets acquired by the corporation from Petitioners, except the patent, could have been purchased in the open market at the depreciated cost shown in the stipulation and incorporated in the Board's findings of fact.

9. The Board of Tax Appeals erred in holding that the gain, if any, derived by Petitioners on account of the transfer by them of their assets in exchange for stock of the Halliburton Oil Well Cementing Company, a corporation, was taxable only at the rate provided for in the capital gain provisions of the Revenue Act of 1924:

10. The Board of Tax Appeals erred in failing to find that the only patent owned by said partnership transferred to said corporation was Patent No. 1,369,891 acquired by Petitioners on March 1, 1921.

11. The Board of Tax Appeals erred in holding that "There is, however, no evidence that either of the patents or the license to use the third was ever owned by the partnership."

12. The Board of Tax Appeals erred in holding that "the patents were issued to Halliburton and the license was in his name and there is no evidence of any assignment to the partnership".

13. The Board of Tax Appeals erred in failing to find that the depreciated cost of $12,216.51, as shown in its Findings of Fact, was that of Patent No. 1,369,891.

14. The Board of Tax Appeals erred in finding, contrary to the evidence, that the Petitioners transferred to the corporation Patent 1,486,883.

15. The Board of Tax Appeals erred in failing to find that the corporation acquired from Petitioners only Patent 1,369,891 and that it acquired a license only to use Patent 1,486,883.

16. The Board of Tax Appeals erred in determining deficiencies against Petitioners, Erle P. Halliburton and Vida C. Halliburton, for the year 1924 in the sums of $23,946.10 and $21,649.89, respectively.

17. The Board of Tax Appeals erred in denying Petitioners' motion for rehearing filed on July 25, 1932, which requested the Board to vacate and set aside its order and decree entered on the 31st day of March, 1932.

LAW AND ARGUMENT.

POINT I.

Petitioners Did Not Realize Taxable Income on Account of the Acquisition by Them of 1,780 Shares of the Capital Stock of Halliburton Oil Well Cementing Company, a Corporation, in Exchange for Their Properties.

Section 203 (b) (4) of the Revenue Act of 1924 provides that:

> "No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange."

Section 203 (i) of the same Act defines "control" as meaning the *ownership* of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

It is believed that the word "immediately" denotes time. It has reference to the time of the "transfer" or "exchange" of property. The foregoing section has no reference to corporate reorganization, but refers merely to transfers of property to a corporation. We must, therefore, determine (1) when the exchange took place and (2) what Petitioners' rights were immediately after the exchange. However, before discussing these phases of the case it may be helpful to understand the historical development of the statute under consideration.

It was in the Revenue Act of 1921 (Sec. 202 (c)) that Congress first adopted the policy of deferring the tax on certain exchanges. Prior to that Act it was common knowledge that the exchange provisions of the Revenue Acts provoked uncertainty and caused a great deal of hardship. This is verified by the Report of the Senate Finance Committee on the Internal Revenue Bill of 1921 (No. 275) wherein the following was stated:

> "Exchanges of Property for Property.
>
> "Section 202 (subdivision c) provides new rules for those exchanges or 'trades' in which, although a technical 'gain' may be realized under the present law, the taxpayer actually realizes no cash profit.
>
> "Under existing law 'when property is exchanged for other property, the property received in exchange shall, for the purpose of determining gain or loss, be treated as the equivalent of cash to the amount of its fair market value, if any * * *.' Probably no part of the present income tax law has been productive of so much uncertainty or has more seriously interfered with necessary business readjustments. The existing law makes a presumption in favor of taxation. The proposed act modifies that presumption by providing that in the case of an exchange of property for property no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value, and specifies in addition certain classes of exchanges on which no gain or loss is recognized even if the property received in exchange has a readily realizable market value. These classes comprise the cases where

> productive property (other than stock in trade or property held primarily for sale) used in a trade or business is exchanged for property of a like kind or use; where in any corporate reorganization or readjustment stock or securities are exchanged for stock or securities of a corporation which is a party to or results from such reorganization; and where an individual or individuals transfer property to a corporation and after such transfer are in control of such corporation.
>
> "The preceding amendments, if adopted, will, by removing a source of grave uncertainty and by eliminating many technical constructions which are economically unsound, not only permit business to go forward with the readjustments required by existing conditions but also will considerably increase the revenue by preventing taxpayers from taking colorable losses in wash sales and other fictitious exchanges."

From the foregoing it is seen that Congress intended to aid business expansion, which was prohibited by the tax liabilities imposed by prior acts. It was plainly the intention of Congress that taxpayers receiving only stock in exchange for their properties should not be subject to tax if they owned 80 per cent of the stock of the corporation. Congress recognized that it was economically unsound to compel taxpayers to pay a tax until they had received cash or its equivalent.

Petitioners were not any richer after the exchange than they were before; they had parted with the ownership of properties merely for certificates evidencing an interest in the same properties. Under such circumstances it would be economically unsound to compel them to pay a tax.

(1) Petitioners on July 1, 1924 Exchanged Their Properties Solely for Stock.

The Board of Tax Appeals in its opinion recognized that the corporation on July 1, 1924 acquired Petitioners' properties. In this connection the Board stated:

> "The record is clear that the corporation began business as of July 1, 1924. On that date the parties of the first part delivered the assets of the partnership which, from that date, were used in the operation of the corporation." [R. p. 52.]

Despite the foregoing, the Board seemed to feel that the exchange was not completed until July 23, 1924, because Mr. Halliburton's signature on the deed to the real estate and the assignments of the patent and patent rights was not attested until that date.

It is believed that the Board failed to recognize the fundamental principles of law governing Petitioners' rights. The Board of Tax Appeals and the courts in many instances have held that an exchange for tax purposes is completed when the purchaser acquires possession, becomes entitled to the benefits, and assumes the burdens of ownership of the property. *Georgia Manufacturing Co.,* 5 B. T. A. 893 (page 38 of Petitioner's Brief).

The corporation, as contemplated by the contract, took possession on July 1, 1924 of the assets and from that date retained continuous possession thereof and operated the oil well cementing business theretofore carried on by the partnership. On and after said date all operating contracts were made in the name of the corporation which then opened a set of books that reflect its income and operations thereafter. [R. p. 50.] The said corporation from July 1, 1924 to July 22, 1924, inclusive, cemented one hundred seventeen wells and made two sales of supplies to outside parties, the entire revenue from which was at all times claimed and kept, and was received by, the said corporation. [R. pp. 111-112.]

During the same interval of time the said corporation dealt with outside parties in its own name in the purchase of necessary supplies, established a bank account, made a deposit therein and drew checks thereon in payment of current expenses and that during the same interval of time the vice-president wrote to producers at various points in Texas and Oklahoma, advising them that the corporation was operating and had equipment available at various points in those states. During this time the corporation, in addition to its officers, employed clerical help, shop foremen, mechanics, warehouse men, cementers, and drivers and helpers in its own name, and on or about July 15, 1924 payrolls of these employees were approved by officers of the corporation, and on July 17, 1924 the officers of the corporation had a policy of fire insurance written in the name of said corporation on the buildings and equipment then in its possession. [R. pp. 112-113.]

On July 12, 1924, a meeting of the Board of Directors attended by six members thereof was held, at which meeting the certificate of incorporation and the by-laws adopted at the incorporator's meeting held at Wilmington, Delaware, on July 1, 1924, were duly ratified and adopted and the persons so designated in the promoter's agreement were elected to the respective offices of president, vicpresident and secretary-treasurer at the salaries specified in said agreement. [R. p. 48.]

The real estate included in the list of partnership assets was transferred to the corporation by deed dated July 1, 1924, but the signatures of Erle P. Halliburton and Vida C. Halliburton affixed thereto were not attested until July 16 and July 23, respectively. The patent and patent rights included in the assets transferred were assigned to the corporation by instruments dated July 1, 1924, but the signatures thereto were not attested until July 23 of such year. [R. p. 50.]

On July 23, 1924, the parties of the second part, the seven oil companies, paid in their subscription on the stock of the corporation in cash in the amount of $130,000.00. Immediately after the effective date of the organization of the corporation, Erle P. Halliburton and Vida C. Halliburton owned capital stock of the corporation represented by 1,780 shares of stock issued, or to be issued, for which they had paid in the assets of the partnership above referred to. [R. pp. 50-51.] Petitioners' interests in said stock is and was immediately after the exchange the same as their interests in the said assets before transfer thereof to the corporation, to wit, one-half or fifty per centum. [R. p. 116.] It was, therefore, on July 1, 1924 that Petitioners surrendered to the corporation their possession and their rights to the benefits of the properties; it was then that the corporation assumed the burdens of ownership. The exchange was, therefore, completed on July 1, 1924.

The courts have held that the formal matters of attesting signatures do not detract from the rights of the contracting parties. The passing of title is not dependent upon the acknowledgment of a deed or the attestation of a signature. As between the parties the deed is valid and effective in passing title. Acknowledgment is essential only for the purpose of recordation. The exchange was made in Oklahoma and, therefore, would be controlled by its laws.

Section 5251 of the Compiled Oklahoma Statutes 1921 specifically provides that:

> "Except as hereinafter provided, no acknowledgment or recording shall be necessary to the validity of any deed, mortgage or contract relating to real estate as between the parties thereto; * * * but no deed * * * relating to real estate other than a lease for a period not exceeding one year * * * shall be valid as against third persons, unless acknowledged and recorded as herein provided."

The Oklahoma courts have consistently held that an acknowledgment is not essential to the validity of a deed.

In *Funnell v. Conrad,* 74 Okla. 29, 176 Pac. 904, the court had under consideration the question of the sufficiency of the acknowledgment of an instrument executed by a mark. In the opinion the court stated:

> "* * * As no acknowledgment was essential to the validity of the deed as between the original parties, the objection as to the form of the acknowledgment becomes immaterial."

In *Ussery v. Driver,* 104 Okla. 155, 231 Pac. 214, the court again stated:

> "* * * But, as to whether they were acknowledged is a matter of no consequence. Under Section 5251, Comp. Stat. 1921, the instruments are good as

> between the parties grantors and grantees without any acknowledgment or compliance with recordation acts and there seems to be no intervening interests of third parties in this case."

See, also:

United States v. Black, 247 Fed. 942.

The record shows that Erle P. Halliburton signed deeds and assignments which were then sent to California where Vida C. Halliburton executed and acknowledged them on July 16, 1924. These instruments were then (prior to July 23, 1924) delivered to the secretary of the corporation.

The acknowledgment of an assignment of a patent is not necessary either to the validity or legal effectiveness or to the right to record it in the patent office. An assignment of a patent is fully executed by the signature of the assignor and acknowledgment of the signature is unnecessary to convey legal title.

Walker on Patents, 1917 Edition, pages 328, 338, 339, 344, 345.

See, also:

Section 4898 of the Revised Statutes.

The requisite elements of transfer of legal title to both realty and patent rights are, first, competent parties, which point is not in question; second, proper consideration, which likewise is not in question; third, the execution and delivery by the grantors or assignors of a deed or assignment in writing; and, fourth, the acceptance thereof by the grantee or assignee, his agent, or a third person for his benefit.

The Supreme Court of Oklahoma, in *Masters v. Teller,* 7 Okla. 668, 56 Pac. 1067 said (Syllabus No. 3):

> "A sale is sufficient if it places the property at the disposal of the vendee and gives him, not only the title, but the constructive possession of the property, with power to reduce it to actual possession at his own pleasure."

In *Phoenix Ins. Co. v. Quintette,* 36 Okla. 384, 128 Pac. 723, 724, the Supreme Court of Oklahoma stated:

> "It scarcely seems necessary to cite authorities to show that when Gray was put in possession under the contract set out above there was a change in plaintiff's interest. * * * If Gray performed his contract, plaintiff could never regain possession of the goods and could have been compelled to make a further conveyance if necessary."

In view of the foregoing it is respectfully submitted that Petitioners on July 1, 1924, exchanged, their properties solely for stock and therefore the exchange came directly within the letter as well as the spirit of the statute. The statute, as heretofore indicated, refers merely to an "exchange".

The section under consideration is not in any way dependent upon any other section of the statute other than 203 (i) containing the definition of "control". In other words, Section 203 (b) (5) is not a section relating to reorganization but is a section relating entirely to an exchange. The exchange actually having taken place prior to July 23, 1924, and the Petitioners having been "in control" of the corporation "immediately after the exchange" the fact that the seven oil companies were obligated to, and did later, buy stock is wholly immaterial. Since Petitioners, immediately after the exchange, were the owners of · at least 80 per cent of the corporation's stock, the exchange came directly within the statutory requirement.

(2) Immediately After the Exchange Petitioners Owned All of the Issued Stock of the Corporation.

Petitioners, having on July 1, 1924 paid their entire consideration, became the owners of 1,780 shares of the capital stock of the corporation and from that date and until July 23, 1924 Petitioners were the owners of all of the issued stock of the corporation.

It is the general rule of law that a stock certificate is merely the paper evidence of an incorporeal right, and stands on a footing similar to that of other muniments of title. It is not in itself property, but is merely the symbol or paper evidence of property, hence the proprietary right may exist without a certificate. (*Black Eagle Mining Co. v. Conray et al.*, 94 Okla. 199 (at page 201), 221 Pac. 425.) The Board of Tax Appeals recognized this rule in the case of *Minal E. Young, Exr.*, 6 B. T. A. 472, at 509 and 510, in which it was stated:

> "It is not necessary that a stock certificate be actually issued or transferred in order to constitute a person a stockholder in a corporation. * * *
>
> " * * * While it may be true that a division or distribution by a corporation is not taxable to a stockholder who is on the cash receipts and disbursements basis until the amount of the distribution is made available to him, this does not mean that, when stock

> of one corporation is distributed by another, the certificate itself must actually be received before there can be taxable gain. Since a person may be a stockholder in a corporation without ever having received a stock certificate, the time of the actual receipt of the stock certificate is immaterial. * * * We think they became the owners thereof in 1918 by virtue of the resolution distributing the stock."

The Supreme Court of the United States, in the case of *Pacific National Bank v. Eaton,* 141 U. S. 227, 11 S. Ct. 984, said:

> "* * * Millions of dollars of capital stock are held without any certificate; * * * A certificate is authentic evidence of title to stock, but is not the stock itself, nor is it necessary to the existence of the stock."

The Halliburton Oil Well Cementing Company, being the corporation organized pursuant to the agreement of June 19, 1924, was a Delaware corporation and, therefore, was subject to the Constitution and laws of Delaware.

Section 3, Article IX, Constitution of the State of Delaware provides:

> "No corporation shall issue stock, except for money paid, labor done or personal property, or real estate or leases thereof actually acquired by such corporation."

It is thus seen that the corporation was prohibited from issuing stock to any other than those who had actually paid consideration therefor. Petitioners were the only ones prior to July 23, 1924 who had paid the consideration for their stock and were consequently the only stockholders of the corporation. A party who has entered into a contract to subscribe for stock does not own the stock until consideration is paid therefor. The promise to pay even though accepted by a corporation does not make the subscriber a stockholder. (*United States Radiator Company v. State of New York,* 208 N. Y. 144, 101 N. E. 783.)

> "It is sometimes loosely said that a subscriber to stock in a proposed corporation becomes a stockholder by virtue of the subscriptions in the absence of any provision to the contrary. But it is more accurate to say that a mere subscription to stock in a proposed corporation does not constitute the subscriber a stockholder." (7 R. C. L. 298—part of Paragraph 274.) (See also 14 C. J. 839.)

Fletcher on Corporations states:

> "Agreements solely between individuals as such do not constitute a subscription to stock. So a contract of subscription is distinguishable from a contract between a number of persons by which they agree, merely between themselves, to form a corporation, and take stock therein, not intending a contract with the corporation when formed. On such a contract, the corporation, not being a party thereto, cannot maintain an action." (Vol. 4, Chap. 12, Sec. 1365, Fletcher Cyclopedia Corporations.)

In *Philadelphia Medical Pub. Co. v. Wolfenden,* 248 Pa. 450, 94 Atl. 138, it was held that a transaction between the defendant and a third person, acting as an individual and for himself alone, whereby the defendant agreed that, if such person would turn over a publication owned by him to a corporation not yet incorporated, the defendant would invest a certain sum in the enterprise for which he was to receive a certain number of shares of stock, was not a subscription to the stock of the corporation which the latter could enforce after its incorporation, but that if any binding engagement resulted it was with such third person individually.

If the corporation is not yet organized, the agreement is to subscribe for shares when it is organized, and does not make the person entering into it a stockholder upon the formation of the company, but something more remains to be done before he can acquire that status; *i. e.,* the actual subscription. (*Sanders v. Barnaby,* 166 App. Div. 274, 151 N. Y. Supp. 580.)

A contract to subscribe in the future does not make one a stockholder immediately upon its acceptance, but is executory in character, and looks to the future for its consummation by a subscription then to be made. (*Webb v. Moeller,* 87 Conn. 138, 87 Atl. 277.)

There was a substantial difference on July 1, 1924 between the rights of Petitioners and the rights of the oil companies who were the other parties to the agreement of June 19, 1924. There is much law defining the liabilities of those who agree to subscribe for stock. The courts have not hesitated to hold them responsible under their contracts and in doing so have intimated that a subscriber was in effect a stockholder. We believe this rule of law has its limitations and is applicable only to the circumstances giving rise to its creation, and that it has no material bearing on the issues in this case. Certainly a person who agrees to subscribe for stock is not the owner of the stock until consideration therefor has passed to the corporation. In the true sense a stockholder is a person *who owns shares of stock in a corporation.* It is ownership of stock that the statute under consideration is concerned with because the statute defines control as the ownership of 80 per cent of the corporation's stock. "Ownership" involves a property right rather than a mere right to create a property right. Petitioners certainly had a property right in the corporation from the moment their assets were acquired by it. Petitioners were the only ones who had a property right in the corporation from July 1, 1924 until July 23, 1924. If the corporation had been dissolved during this period Petitioners alone would have shared in the distribution of assets. The seven oil companies, during this period had only a right to create a property interest in the corporation.

The Board of Tax Appeals in the case of *Federal Grain Corporation v. Commissioner of Internal Revenue,* 18 B. T. A. 242, at page 248, stated:

> "While the foregoing satisfactorily disposes of the issue under the pleadings, it is proper, we believe, since the issue was presented and argued almost entirely upon the question of control of the petitioner by the transferors, that we express our views with respect thereto. Section 203 (i) of the Revenue Act of 1924 defines the word 'control' to mean 'the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation'. *In other words, the term 'control' relates to 'ownership' and has no bearing upon the actual control over the corporate affairs which a stockholder exercises through his vote; therefore, the fact that the agree-*

> *ment of April 25, 1924, vested the voting rights in the trustee is of little or no importance."* (Italics ours.)

In view of the foregoing it is immaterial what rights the seven oil companies had by virtue of the contract of June 19, 1924. They did not own the stock until they had paid the consideration therefor. Therefore, they were not in control of the corporation, Petitioners alone being in control. The foregoing opinion of the Board answers the statement made by the Board in the instant case that, therefore, it was immaterial that representatives of the seven oil companies participated in the corporate activities. Petitioners having fully paid their consideration for the stock, became actual owners thereof, and since they were the only owners of the corporation's stock, the transaction was a tax-free exchange.

The Delaware law prohibited the corporation from issuing stock to the seven oil companies prior to the receipt of consideration therefor.

The Supreme Court of Delaware held that:

> "The note of a stock subscriber, given in payment of capital stock issued to him is not property actually acquired within Const. Art. 9, Sec. 3, providing that no stock can be legally issued except for money paid, labor done, or property actually acquired."
>
> *Lofland v. Cahall*, 118 Atl. 1, 114 Atl. 224.

The term "stock" as used in Section 203 (i) of the Revenue Act of 1924 means issued stock and not authorized capital stock. Certainly a person who owns 80 per cent of all the issued stock of a corporation is in control of the corporation within the meaning of the statute even though the amount issued is less than 80 per cent of the total authorized.

In the case of *United States Radiator Corporation v. State of New York,* 208 N. Y. 144, 101 N. E. 783, the court stated:

> "The statement in the certificate of incorporation or charter of the corporation that the capital stock is a designated amount divided into a certain number of shares, each of a named value, creates neither shares nor capital stock. It expresses the power of the corporation to acquire a capital stock. It creates potential shares which, transferred into actual shares by acquisition of the members and their payments, produce the money or property which, put into a single corporate fund, is the actual capital or capital stock on which the corporate business is undertaken and in which are the shares. It also fixes the sum of the payment necessary to create a share."

See, also:

Thompson on Corporations, Vol. 4 at page 14.

Statutes should receive a sensible construction such as will effectuate the legislative intention and avoid, if possible, an unjust or absurd construction. (*In re Chapman,* 166 U. S. 661.) To hold that the statute contemplated the ownership of at least 80 per centum of the "authorized capital stock" would fail to effectuate the legislative intent. All that would be necessary to escape tax under such construction would be to make the initial authorized capital sufficient only to pay for one's properties and to provide any requisite qualifying shares, file those "Articles", transfer the properties and thereafter (immediately, if desired) increase the "authorized capital stock" and issue the whole, or any part, of the increase to the parties who were to provide the additional capital.

The Board of Tax Appeals, in *Keen & Wolf v. Commissioner,* 15 B. T. A. 542, held that the outstanding capital stock, rather than the authorized capital stock, is the governing factor in the determination of control.

In its opinion the Board, at page 545, stated:

> "* * * Section 331 has reference to the interest or control which exists at the time the stock is issued for property; not to the situation which may exist at some future time if the new company is successful in selling more of its stock. * * *"

The section referred to was in the 1918 Act, and related to invested capital, but is similar in effect to the section under consideration.

In view of the fact that the corporation acquired possession and enjoyed the benefits and assumed the burdens of the properties on July 1, 1924 the Petitioners were in fact and in law stockholders of the corporation. Since the oil companies did not pay in their consideration for their stock until July 23, 1924 they were not either in fact or in law stockholders of the corporation. Consequently, Petitioners from July 1, 1924 to July 23, 1924 were the sole stockholders of the corporation and, therefore, were the owners of all of its stock. The exchange, therefore, was a tax-free exchange within the meaning of Section 203 (b) (4) of the Revenue Act of 1924.

(3) Even Though the Exchange Did Not Take Place Until July 23, 1924 Petitioners and the Seven Oil Companies Immediately After Such Exchange Owned at Least 80% of the Corporation's Stock in the Same Proportion That They Had Theretofore Owned the Properties Transferred.

Without waiving the argument presented under subdivisions (1) and (2), Petitioners urge the following:

Petitioners were two of several persons who transferred properties to the corporation solely in exchange for its stock and immediately after the exchange such group of persons were in control of the corporation and the amount of stock received by each was substantially in proportion to his or her interest in the properties prior to the exchange. Petitioners urge that the exchange took place on July 1, 1924. If the exchange took place on July 23, 1924 then what the corporation acquired from Petitioners and the seven oil companies was property of a mixed character. There is no dispute between the Respondent and the Petitioners that Petitioners and the seven oil companies after July 23, 1924 owned at least 80 per cent of the corporation's stock. Therefore, the question resolves itself into a question of whether or not the properties transferred by Petitioners and the seven oil companies were properties as contemplated by Section 203 (b) (4) of the Revenue Act of 1924. Respondent by and with the approval of the Secretary of the Treasury is authorized to make regulations to enable him to enforce the provisions of the Revenue Acts. Pursuant to this authority the Respondent promulgated his Regulations No. 65 (Article 1572) which, in reference to the section under consideration, contained the following:

> "(c) If property, real, personal, or mixed, is transferred to a corporation (1) by one person solely in exchange for stock or securities in such corporation, and immediately after the exchange such person is in control of the corporation, or (2) by two or more persons, solely in exchange for stock or securities in such corporation and if immediately after the exchange such persons are in control of the corporation, and if the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange. See Article 1577 for definition of 'control'."

It would plainly appear that the transaction came directly within the foregoing Regulation. However, it may be contended by the Respondent that the money—$130,000.00—transferred to the corporation by the seven oil companies was not property within the meaning of the section under consideration. We believe this contention has no merit. Money has always been and is commonly recognized as property. The statute uses words in their usual and ordinary sense. The Supreme Court in the case of *Dewey v. United States*, 178 U. S. 511, stated that it is a court's duty to give effect to the will of Congress, "but we must ascertain that will from the words Congress has chosen to employ, interpreting such words according to their ordinary meaning, as well as in the light of all the circumstances that may fairly be regarded as having been within the knowledge of the legislative branch of the government at the time it acted on the subject".

If Petitioners had transferred property and money solely for stock, there would be no question but what the exchange would be one contemplated by the section under consideration. Suppose that two individuals have for a long time operated a business, the total fair value of which was $100,000.00 which is made up of real estate and buildings of $90,000.00 and $10,000.00 in cash. Would the fact that the $10,000.00 in cash went over to the corporation with the other property take it without the purview of the statute? Such would be the effect if the Respondent's contention in this respect had any merit.

Had the seven oil companies invested the $130,000.00 in other personal property and transferred such property to the corporation for a like amount of stock, certainly the Government would not contend that a gain had been derived by the Petitioners. The new company probably bought other properties with this money.

The word "property" has always included cash. The word "property" as used in the statute is not limited to any specific kind or kinds, but is used in its most comprehensive sense to include all kinds of property. Such an interpretation is in harmony with the views of the Respondent and the Regulations. The Supreme Court of the United States in the case of *Pirie v. Chicago Title & Trust Co.,* 182 U. S. 438, 443, 45 L. ed. 1171, 1176, stated that:

> "* * * Money is certainly property whether we regard any of its forms or any of its theories. * * *"

The Supreme Court in that case did not utter a new truth, but merely expressed a thought common to business men since the memory of man runneth not to the contrary. Certainly, Congress did not mean to so restrict the word "property" as to exclude therefrom money or its equivalent. The Report of the Senate Finance Committee heretofore quoted clearly indicates that it was the intention of Congress to aid rather than hamper business expansion; it also appears that it was the intention of Congress to impose a tax only in those exchanges where a taxpayer had actually realized a gain. Congress did not intend to impose a tax upon a fictitious gain as it regarded such a tax as economically unsound. Taxpayers were no richer after the exchange than before. They merely parted with the title to the properties and received in exchange therefor an interest in a corporation. When they sell their stock they will then have to pay the tax upon the gain derived. It was the intention of Congress to defer this tax. Taxpayers are not escaping the payment of tax but are merely deferring the payment thereof in the manner allowed by the statute.

In view of the foregoing, it is respectfully submitted that the transaction came within the provisions of the statute. It is grossly unfair to deny Petitioners the benefit of the provisions of the statute which Congress, it is believed, intended they should get. A construction denying them the benefit of the statute would place them in a situation which would work a great hardship on them. The intent of Congress is plain and, since the transaction came within the letter and spirit of the law, it is respectfully submitted that the exchange came within the meaning of Section 203 (b) (4) and that, therefore, no taxable gain resulted therefrom.

POINT II.

The Gain, if Any, Realized by Petitioners on Account of the Exchange by Them of Properties for Stock of the Halliburton Oil Well Cementing Company Is Taxable Only at the Rate of 12½%.

The Revenue Act of 1924 provides that the gain derived from the sale or exchange of property held two years or more shall be taxable only at the rate of 12½%. (Section 208 (a) (8) and Section 208 (b).) [See Appendix pages 56-57.]

The question, therefore, resolves itself largely into one of fact. The corporation acquired from Petitioners the following assets:

1. License to use Patent No. 1,011,484 granted December 12, 1911. [See assignment, R. pp. 131-133.]

2. License to use Patent No. 1,486,883 granted March 18, 1924. [See assignment, R. pp. 134-137.]

3. A mixed body of assets of character, cost and value as follows:

Profit and Loss on Sale of Assets and Miscellaneous Investments.

Descrip-tion	Date Sold	Date of Purchase	Cost	Deprecia-tion based on cost	Adjus. Cost	Sale Price	Profit or Loss
Autos	7-1-24	7-1-22-24	$12,660.88	$ 2,968.55	$ 9,692.33		
Trucks	"	1-1-22-24	32,435.20	13,438.17	18,997.03		
Pumps	"	"	17,894.16	7,723.05	10,171.11		
L. Stock	"	"	215.00	53.75	161.25		
Bldgs. (Field)	"	7-1-23-24	22,289.12	420.36	1,868.76		
Off. Bldg. Gar. & Shed	"	"	2,641.04	145.20	2,495.84		
Elevators	"	7-1-22-24	414.96	138.06	276.90	$178,000	$115,290.36
Shop Eq.	"	1-1-23-24	2,429.43	239.33	2,190.10		
F. & F.	"	1-1-22-24	1,894.45	230.79	1,663.66		
Wagons	"	7-1-22-24	612.00	431.33	180.67		
W. H. Supplies	"	1924	2,432.98		2,432.98		
R. E.	"	1922	362.50		362.50		
Patent	"	3-1-21	15,000.00	2,783.49	12,216.51		
Total			$91,281.72	$28,572.08	$62,709.64	$178,000	$115,290.36

The patent referred to in the foregoing list of assets could be no other than Patent No. 1,369,891. It was granted on March 1, 1921 as specified in the foregoing list. The list shows that it was acquired "3-1-21". It was assigned to the corporation on July 1, 1924. [R. pp. 139, 140.]

The Board found as a fact [R. p. 48] that Patent No. 1,486,883 was acquired by the corporation. This Finding is not supported by the record—the record shows that the corporation acquired only a license to use Patent No. 1,486,883. [R. pp. 134 to 137.]

The record discloses that the corporation acquired only Patent No. 1,369,891 around which the partnership business had been built. The foregoing list also discloses that the depreciated cost of the assets at July 1, 1924 was $62,709.64. Included in the assets above specified was property of the depreciated cost of $16,216.51, which had been owned by the partnership for more than two years. [R. p. 50.] The patent, according to the foregoing list, had a depreciated cost of $12,216.51, it having cost the sum of $15,000.00. This patent (No. 1,369,891) had a fair market value on July 1, 1924 of at least $100,000.00. Mr. Halliburton testified that it "was worth $100,000.00 to $115,000.00", [R. p. 104] and Mr. Stoddard, a qualified engineer, testified that its fair market value was between $100,000.00 and $150,000.00. [R. p. 108.] On cross-examination he stated that he computed the value by two different methods, by one of which he arrived at a value of $112,000.00, and by the other at a value of $136,000.00. [R. p. 109.] This evidence is uncontradicted. The Board failed to make a finding on this evidence although the member before whom it was heard stated in his opinion:

> "* * * An engineer of experience and standing testified that in his opinion such patent was worth at least $100,000 on July 1, 1924, and the oral evidence of Erle P. Halliburton is to the same effect." [R. pp. 56-57.]

At the trial below it was apparent that the main asset that was transferred by Petitioners to the corporation was the patent and that consequently it had a very substantial value. This is evidenced by the following colloquy between the member of the Board and counsel for the Petitioners:

> "Mr. Miller.—Your Honor, might I add this one thing, that we contend that the profits through this exchange, which is an agreed amount, attaches to this patented process; and, therefore, the patented process had been held for more than two years—the patent was issued on March 1, 1921, and that—
>
> "The Member.—And that is the sort of a situation that Congress intended to apply the capital stock to.
>
> "Mr. Schlosser.—That is not my idea, Your Honor.
>
> "The Member.—It seems to be a very simple proposition here. Here is a partnership that had been engaged in the manufacture and sale of certain commodities and had accumulated assets worth a good deal more than it cost them, and they decided to organize the corporation and did organize the corporation on the first day of July, 1924, and paid these assets into the corporation for stock.
>
> "Now, it seems to me that the Government is—I presume the Government's position is that they then and there realized a profit upon the difference between

the cost of these assets and the value of the stock. I do not see how it could be.

"Mr. Miller.—Both of which is fixed, but the physical properties were such properties as there was a limited supply of available, at the depreciated cost, or less, and therefore such properties as would not be dealt in with a profit. Therefore, the profit attached to the patent around which the whole business was wound.

"The Member.—*All of the properties transferred to the corporation were properties the partnership acquired and used in its business.*

"Mr. Miller.—But anyone could replace them overnight.

"The Member.—Certainly you could replace them overnight.

"Mr. Miller.—You could not replace the patent.

"The Member.—You could not replace the patent probably, but any partnership converting itself into a corporation has a considerable body of assets that can be replaced.

"Mr. Miller.—Furthermore, the stipulation shows that many of those physical properties had been held more than two years." (Italics ours.) [R. pp. 102-103.]

The record, therefore, conclusively shows that Patent No. 1,369,891 had been held for more than two years; it was the main asset transferred to the corporation, and its value was at least $100,000.00.

Mr. Halliburton testified on cross-examination: "Without patent 1,369,891 I could not possibly have organized the Halliburton Oil Well Cementing Company with the expectation of turning the stock to the second parties to the contract." [R. p. 106.] He also testified that "All of the properties transferred by the partnership to the corporation with the exception of the patent could have been easily acquired in the open market at the place where they were located." [R. p. 104.]

It is quite evident from the list of assets that they could all, with the exception of the patent, have been replaced in the open market at about the depreciated cost. It is, therefore, very evident that the partnership business and the business of the corporation were built around Patent No. 1,369,891. This is also confirmed by the finding of fact made by the Board of Tax Appeals. In its finding it stated [R. p. 47]:

> "The E. P. Halliburton Oil Well Cementing Company, hereinafter called the partnership, was established in 1920 and until July 1, 1924, profitably operated the business of cement oil wells by use of a process patented by Erle P. Halliburton on March 1, 1921. * * *"

The only patent that was granted on March 1, 1921, as heretofore stated, was this patent. Since it had been owned by Petitioners for more than two years, the gain, if any, derived from its disposition would be subject only to the capital gain provisions of the Revenue Act and taxable at the rate of 12½%. Since all the other assets could have been readily replaced in the open market at their depreciated value, their value of $50,493.13 would be the total value that any prudent business man would allot to them. It must be presumed that a prudent business man would not allot a greater value to this kind of assets than their depreciated cost, particularly since they could have been obtained in the open market at this figure.

If the depreciated cost of the patent is deducted from the depreciated cost of the other assets there would remain the sum of $50,493.13 which would represent their fair market value. The stock received by the Petitioners was worth, as disclosed by the record and as found by the Board, the sum of $178,000.00. Deducting the $50,493.13 from the $178,000.00 would leave the sum of $127,506.87 which would represent the sales price of the other intangibles. Since Patent No. 1,369,891 had a fair market value of $100,000.00 this amount should be allotted to it. In view of the testimony it is inconceivable that any other amount should be allotted; the balance thereof would naturally be allotted to the licenses to use Patent No. 1,011,484 and Patent No. 1,486,883. Since the depreciated cost of Patent No. 1,369,891 was $12,216.51, the gain, if any, on account of the disposition of this patent would be the difference between this sum and $100,000.00, to wit, $87,783.49.

There can be no doubt but what Petitioners had owned Patent No. 1,369,891 for more than two years. It is, therefore, respectfully urged that the gain, if any, derived by Petitioners on account of the exchange of this patent is taxable only at the rate of 12½%.

The Board of Tax Appeals, it is respectfully submitted, seem to be confused upon the facts. In its opinion [R. p. 56] it stated:

> "The record discloses that the intangibles paid into the corporation consisted of patents 1,369,781* and 1,486,883, a license to use patent 1,101,484** owned by a competing concern and the good will of the partnership."

*Should be 1,369,891.

**Should be 1,011,484.

As heretofore pointed out, the record does not support this statement. The record is very definite that the corporation acquired only Patent No. 1,369,891 and licenses to use Patents Nos. 1,486,883 and 1,011,484. The Board futher stated [R. p. 56] that:

> "* * * At July 1, 1924, the partnership had been so profitably engaged in the oil well cementing business for a number of years that the stock of the corporation formed to continue and expand its operations was readily salable at or above par. This indicates that the good will transferred to the corporation must have had a very substantial value. * * *"

The record, as heretofore stated, discloses that the partnership had been in business only three years prior to July 1, 1924. It began business in March, 1921. [R. p. 98.] It could not, therefore, have built up a very substantial good will. The business was dependent upon the use of this one patent for cementing oil wells; and the business of cementing oil wells was the partnership's only business. Whatever intangible value the partnership had would naturally attach to the patent and would not constitute the value of good will. Some economists, however, maintain that value of a patent cannot be separated from the value of good will. However, what we are concerned with in this case are facts, and the fact has been established by uncontradicted evidence that the patent did have a value of at least $100,000.00. If the patent had a value of $100,000.00 it cannot reasonably be assumed that the value of all the other assets, including good will, would exceed $78,000:00. It must be assumed that the fair market value of all the assets acquired or transferred by Petitioners was only $178,000.00, the agreed fair market value of the stock received. It is respectfully urged that the Board erred in ignoring the testimony with respect to the value of the patent. Furthermore, it erred in assuming (without facts to justify such assumption) that the partnership had been in business only three years and had a very substantial good will.

The Board further stated [R. p. 56] that:

> "* * * The license to use patent 1,101,484* and patent 1,486,883 must also have had some value since they are made the subject matter of several paragraphs of the promoter's agreement and are specifically assigned to the corporation. * * *"

*Should be 1,011,484.

Since the record discloses that Patent No. 1,486,883 was granted on March 18, 1924, it could not have had a substantial value. Certainly if we are going to determine tax cases on assumptions it must be assumed that this patent had little or no value. It was error for the Board to ignore the testimony proving that all the assets other than Patent 1,369,891 acquired by the corporation had a value of only $78,000.00.

The Board further stated [R. p. 57]:

> "Since the stipulation merely specified 'patent' without any descriptive number, we cannot determine that the agreed depreciated cost of $12,216.51 was that of patent 1,369,891 alone or included the other patent and the license to use a third. * * *"

As heretofore stated, the foregoing record does not contain a descriptive number properly identifying this patent. The entire evidence shows that there was only one patent that was turned over to the corporation. The assignment shows that there was only one instrument assigning a patent and that related to Patent No. 1,369,891. The Board evidently overlooked the significance of the date specified in the record, to wit, March 1, 1921. It also overlooked the significance of the instrument transferring title to the corporation. Since there was only one patent transferred to the corporation it must be taken as an established fact that it was this patent. This is further emphasized by the testimony of Mr. Halliburton, who stated [R. p. 100]:

> "* * * I had actual knowledge of the value on July 1, 1924, of the patent numbered 1,369,891 which was transferred in this transaction. * * *"

The Board seemed to be confused about whether the partnership had any interest in the patent or patent rights. This is evidenced by the following quotation [R. p. 57]:

> "* * * There is, however, no evidence that either of the patents or the license to use the third was ever owned by the partnership. * * *"

The foregoing statement, it is respectfully submitted, is based upon an erroneous conception of the facts.

The Board evidently overlooked the fact that title to properties belonging to a partnership is often held in the name of one of the individuals. It was unnecessary to have the patent and the patent rights assigned to the partnership. The whole case before the Board was presented on the theory that the patent and the two licenses to use the other two patents were owned by the partnership. The Board member who heard the case (and who wrote the opinion) was under the impression at the time of the trial that all of the assets acquired by the corporation were assets that belonged to the partnership. This is evident from the following statement made by the member [R. p. 103]:

> "The Member.—*All the properties transferred to the corporation were properties the partnership acquired and used in its business.*" (Italics ours.)

The last statement of the member of the Board, it is respectfully submitted, clearly indicates that it was understood at the trial that all of the properties that were transferred to the corporation were properties the partnership acquired and used in its business. This statement of the Board is supported by the record. It is immaterial that the patent or the licenses to use the other two patents were actually assigned to the partnership. There can be no doubt but what the partnership owned Patent No. 1,369,891. It was the patent around which the partnership's business had been built, as heretofore shown, and it was the patent specified in the list of partnership assets transferred to the corporation. The partnership and the individuals composing it are not separate entities. It is immaterial in the determination of this question whether the title to the patent or the assignments was in the name of the partnership or merely in the name of one of the partners. The important thing to determine is whether Petitioners' interests in the properties transferred to the corporation were the same as their interests were in the stock acquired. The Petitioners and Respondent stipulated this fact. Paragraph (9) of the stipulation upon which the case was tried provides [R. p. 116]:

> "Petitioner's and his said partner's interests in the capital stock of the Halliburton Oil Well Cement-

> ing Company, received in exchange for assets by them transferred to the said Company, is, and was immediately after the exchange the same as their interests in the said assets before transfer thereof to the said Company, to wit: One-half or Fifty per Centum each."

The stipulation did not just refer to the assets listed. It contained a copy of the contract of June 19, 1924; and it also provided [R. p. 111]:

> "The personal property provided to be transferred by Erle P. Halliburton and Vida C. Halliburton, by paragraph 4 (f) of the said contract of June 19, 1924, together with the other properties as provided by the contract of June 19, 1924, were delivered into possession of representatives of the said corporation, Halliburton Oil Well Cementing Company, and the said corporation entered into the possession and use thereof on July 1, 1924 and retained continuous possession and use thereof thereafter."

The contract of June 19, 1924 specifically provided that Petitioners should transfer Patent No. 1,369,891 and license to use Patent No. 1,486,883 and license to use Patent No. 1,011,484.

In view of the foregoing stipulation it was unnecessary for Petitioners to prove that the title to the patent or the two licenses actually reposed in the name of the partnership; it was likewise unnecessary for them to prove that the patent or the two licenses were held by one of the partners for the benefit of the partners. The only conclusion that can be derived from the foregoing is that the patent and the licenses to use the other two patents did actually belong to the partnership.

The patent was a capital asset within the meaning of the provisions of the Revenue Act of 1924 [Section 208 (a) (8), Appendix page 56]. The statute defines the term "capital assets" as meaning "property held by the taxpayer for more than two years * * *, but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business".

It is very evident that the patent could not properly be included in Petitioners' inventory. Certainly the patent was not held primarily for sale. The kinds of property to be "included in the inventory" as that phrase is used in the statute, are those in which a taxpayer deals or which he uses in an income producing business, and which must be inventoried at the beginning and end of a taxable period in order to determine income for that year. In its very broadest significance, the term "inventory" means merely a list of property, generally with valuations stated. But the statute and regulations here under consideration relate to the determination of income for taxing purposes and the term "inventory" as used in this connection can mean only such inventory as is necessary or proper for a determination of income over the taxable period.

For a thorough and well considered discussion of the question of the kinds of property that should be inventoried, within the meaning of the Revenue Acts, see the following authorities:

> *Burroughs Adding Machine Co.,* 9 B. T. A. 938;
>
> *Francisco Sugar Co. v. Commissioner,* 47 Fed. (2d) 555.

The patent under consideration was a fixed and permanent asset of the business; it has the same general character as land, buildings, machinery and equipment. This kind of property, though worn or exhausted in use or by the lapse of time, is not directly consumed in the manufacture of articles which are themselves sold for the production of income. It is not to be included in inventory at the beginning and end of a taxable period for the determination of income. The patent was kept for use and not for sale. It was the main asset of the partnership and the asset around which the partnership had been built.

It may be argued by Respondent that because part of the assets transferred was "stock in trade" and also because a going business and incidental good will were included in the transfer that Petitioners were not entitled to the application of Section 208 (a) (8). This contention, it is respectfully submitted, would have no merit. The patent was not "stock in trade" but was a fixed asset, the cost of which has been definitely determined, and to which has been apportioned a part of the consideration. There is no reason why in the transfer of a group of assets for a lump consideration there should not be allocated to each item of such group its actual fair market value. The Respondent has made similar allocations numerous times. A common case is where improved real estate is purchased for a lump sum. In such a case, in order to determine depreciation allowances on the improvements, part of the cost must be allocated to improvements and the remainder to the ground value. This is ordinarily done by proving the actual fair market value of the improvements at the time of the transfer. This is the principle Petitioners followed in presenting their evidence before the Board.

In the instant case the evidence shows that only one item of stock in trade was transferred. This was warehouse supplies of a stipulated cost of $2,432.98. [R. p. 49.] As to them there was neither gain nor loss in the transfer. They were acquired in 1924, and hence were not held for two years, but only for a few months at most. None of the other items were "stock in trade" as this term is defined by the Board and the courts.

In the case of *Peter A. Miller v. Commissioner,* 20 B. T. A. 230, the Board held that an apartment house was not part of the petitioner's "stock in trade" because he was not engaged in the business of buying and selling real estate.

In the case of *George H. Peck v. Commissioner,* 19 B. T. A. 345, it was held that the petitioner was not engaged in buying and selling real estate as a business and that, therefore, real estate owned and sold by him (in considerable quantities) was not his "stock in trade".

In *Woodworth & Co. v. City of Concord,* 96 Atl. 296, the Supreme Court of New Hampshire said:

> "* * * 'Stock in trade' includes only visible and tangible property such as merchandise or goods kept for sale or traffic, * * *."

See also:

Cooley on Taxation, Vol. 2, 1924 edition, p. 1256.

An examination of the items listed in the table referred to [R. p. 49] shows that all of them, except warehouse supplies, were property which the partnership used in carrying on its business, and were not kept for sale in the ordinary course of its business, and were not manufactured or consumed in the carrying on of its business, except by depreciation or ordinary wear and tear in use. It would be unreasonable to contend that such a small item as "stock in trade" should be sufficient to deny to Petitioners the right to have their taxes computed under Section 208 (a) (8). If Petitioners realized a gain, such gain is subject to a tax of only 12½%. The uncontradicted evidence shows that Petitioners transferred a physical asset, to wit, Patent No. 1,369,891, for which they received stock; the evidence further shows that $100,000.00 of the consideration was properly allocated to the patent.

The evidence clearly shows that the main asset transferred to the corporation in consideration for $178,000.00 worth of stock was Patent No. 1,369,891 around which the partnership had been built. Since this patent had a value of $100,000.00 at that time it must be assumed that all the other properties transferred to the corporation had a value not in excess of $78,000.00. Other physical properties transferred to the corporation had a value, as disclosed by the record, of $50,493.13. There was left, therefore, the sum of $27,506.87 to be allotted to the two licenses to use the other two patents and whatever good will was acquired. It was entirely unnecessary, under the circumstances, for Petitioners to prove the actual value of these two licenses, or to prove the actual value of the good will, if any. Most of the properties, other than Patent No. 1,369,891, acquired by the corporation were held by Petitioners less than two years. Petitioners are entitled to a tax rate of 12½% only on the property held two years or more. The record discloses that Patent No. 1,369,891 had been held more than two years and also what portion of the profit, if any, was allocable thereto. Having established the value of the patent at the time it was transferred and its date of acquirement, it was not incumbent upon Petitioners to prove the value of every other asset. It is quite obvious that the value of these other assets would have been immaterial. No matter what value the assets other than the main patent had, the evidence, it is respectfully submitted, entitled Petitioners to the benefit of the capital net gain provisions in determining the tax on the gain, if any, on account of the disposition of this patent.

In view of the foregoing it is respectfully submitted that the decision of the United States Board of Tax Appeals is erroneous and should be reversed.

Respectfully submitted,

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APPENDIX.

Revenue Act of 1924:

"Sec. 203. (b) (4) No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange."

*   *   *   *   *   *   *   *   *

"Sec. 203. (i) As used in this section the term 'control' means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation."

Regulations 65, Article 1572:

"(c) If property, real, personal, or mixed, is transferred to a corporation (1) by one person solely in exchange for stock or securities in such corporation, and immediately after the exchange such person is in control of the corporation, or (2) by two or more persons, solely in exchange for stock or securities in such corporation and if immediately after the exchange such persons are in control of the corporation, and if the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange. See Article 1577 for definition of 'control'."

Revenue Act of 1924:

"Sec. 208. (a) For the purposes of this title—

(1) The term 'capital gain' means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921;

(2) The term 'capital loss' means deductible loss resulting from the sale or exchange of capital assets;

(3) The term 'capital deductions' means such deductions as are allowed by section 214 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year;

(4) The term 'ordinary deductions' means the deductions allowed by section 214 other than capital losses and capital deductions;

(5) The term 'capital net gain' means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gain;

(6) The term 'capital net loss' means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain;

(7) The term 'ordinary net income' means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions; and

(8) The term 'capital assets' means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not in-

clude stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business."

"(b) In the case of any taxpayer (other than a corporation) who for any taxable year derived a capital net gain, there shall (at the election of the taxpayer) be levied, collected and paid, in lieu of the taxes imposed by sections 210 and 211 of this title, a tax determined as follows:

"A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner provided in sections 210 and 211, and the total tax shall be this amount plus 12½ per centum of the capital net gain."